

The computation of base income automatically incorporates the effects on federal taxable income of an IRC Section 338(h)(10) election.

June 19, 2014

Re: Request for General Information Letter; Illinois Withholding

Dear Xxxxx:

This is in response to your letter dated March 20, 2014 in which you request a legal tax ruling whether certain payments made to nonresident aliens and/or foreign entities require the UNIVERSITY to withhold Illinois Income Taxes from such payments. The Department's regulations require that the Department issue only two types of letter rulings, Private Letter Rulings ("PLRs") and General Information Letters ("GILs"). PLRs are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding against the Department, but only as to the taxpayer issued the ruling and only to the extent the facts recited in the PLR are correct and complete. GILs do not constitute statements of Department policy that apply, interpret or prescribe the tax laws and are not binding against the Department. See 2 Ill. Adm. Code 100.1200(b) and (c). The nature of your letter and the information provided require that we respond with a General Information Letter.

Your letter states as follows:

The UNIVERSITY (UNIVERSITY) has a large population of nonresident alien students and visitors/scholars and conducts business internationally with other foreign individuals and entities. The UNIVERSITY makes payments to these individuals and entities for a multitude of reasons, including salaries, wages, honoraria, independent contractor, expense reimbursements, scholarships, fellowships, and royalty payments. Depending on the factors for each unique circumstance, the payment may or may not be subject to federal income tax withholding.

The UNIVERSITY requests information from the Illinois Department of Revenue (IDoR) regarding whether Illinois state income tax withholding is required on certain **non-wage** payments made to individual nonresident aliens and/or foreign entities when federal income tax withholding is required per IRS regulations.

## RELEVANT CITATIONS

In accordance with the Illinois Income Tax Act at 35 ILCS 5/701(a):

Every employer maintaining an office or transacting business within the state that is required to withhold federal income tax on **compensation** paid in Illinois to an individual must withhold Illinois income tax.

Also, the Illinois Income Tax Act at 35 ILCS 5/1501(a)(3) states:

Compensation consists of wages, salaries, commissions and any other form of remuneration paid to employees for personal services.

IDoR Publication 130 (<http://www.revenue.sate.il.us/Publications/Pubs/Pub-130.pdf>) provides:

Who is required to withhold Illinois Income Tax?

Generally, you must withhold Illinois Income Tax if you are required to withhold (or have a voluntary agreement to withhold) federal income tax from payments you make for

- employee compensation (*i.e.*, wages and salaries) paid in Illinois, or
- gambling or lottery winnings in Illinois paid to an Illinois resident.

## **TAXPAYER'S POSITION**

The UNIVERSITY takes the position that there are no Illinois state income tax withholding requirements on non-wage payments made to nonresident aliens and foreign entities when federal income tax withholding is required. These payments include scholarships, fellowships, independent contractor, expense reimbursements, honoraria, and royalty payments.

## **INFORMATION REQUESTED**

The UNIVERSITY requests confirmation regarding Illinois state income tax withholding requirements for the following types of payments made to individual nonresident aliens and/or foreign entities when federal income tax withholding is required:

- 1) Scholarships and Fellowships,
- 2) Independent contractor,
- 3) Expense reimbursements,
- 4) Honoraria, and
- 5) Royalties.

If withholding is required, what is the required rate of withholding?

Also, if the UNIVERSITY is not required to withhold, but would like to withhold Illinois income tax as a service to the recipient of the payment, could it withhold Illinois income tax at its discretion? For example, when the UNIVERSITY pays non-qualified scholarships (*i.e.* taxable scholarships) to students, could it withhold 5% (the current individual rate) state of Illinois Income tax on the students' behalf?

## **RESPONSE**

Your letter requests guidance as to certain payments made to nonresident alien students, visitors/scholars and other foreign individuals and entities. Your letter indicates that the payments in question are "non-wage payments," but that federal income tax withholding is required per IRS regulation.

Illinois Income Tax Act (IITA) Section 701(a), 35 ILCS 5/701(a) provides that:

Every employer maintaining an office or transacting business within this State and required under the provisions of the Internal Revenue Code to withhold a tax on ... compensation paid in this State (as determined under Section 304(a)(2)(B)... shall deduct and withhold [Illinois Income Tax] from such compensation.

IITA 304(a)(2)(B) states in relevant part that:

(B) Compensation is paid in this State if

- (i) The individual's service is performed entirely within this State;

- (ii) The individual's service is performed both within and without this State, but the service performed without this State is incidental to the individual's service performed within this State; or
- (iii) Some of the service is performed within this State and either the base of operations, or if there is no base of operations, the place from which the service is directed or controlled is within this State, or the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this State.

With respect to distinguishing an employee from an independent contractor, please note that the Illinois Income Tax Act ("IITA") does not define the terms "employee" and "independent contractor." Section 102 of the IITA requires the Department to follow the Internal Revenue Service's determination of whether an individual is an "employee" or "independent contractor".

Section 102 of IITA states as follows:

Except as otherwise expressly provided or clearly appearing from the context, any term used in this Act shall have the same meaning as when used in a comparable context in the United States Internal Revenue Code of 1954 or any successor law or laws relating to federal income taxes and other provisions of the statutes of the United States relating to federal income taxes as such Code, laws and statutes are in effect for the taxable year. (Source: P.A. 77-726.)

Illinois rules defining "compensation" discuss the meaning of the word "employee."

#### b) Employee

Compensation is defined as remuneration for personal services performed by an "employee". If the employer-employee relationship does not exist, remuneration for services performed does not constitute "compensation." The term "employee" includes every individual performing services if the relationship between him and the person for whom he performs such services is the legal relationship of employer and employee. The term has the same meaning under the Illinois Income Tax Act as under 26 U.S.C. Section 3401(c) and 26 CFR 31.3401(c)-1.

86 Ill. Adm. Code 100.3100(b). Thus, an "employee" for federal tax purposes is also an "employee" for Illinois income tax purposes. Likewise, an "independent contractor" for federal tax purposes is an "independent contractor" for Illinois income tax purposes.

Department of Revenue Regulations Section 100.7000(a) states:

Every employer maintaining an office or transacting business within this State and required under the provisions of 26 USC 3401 through 3404 to withhold and pay federal income tax on compensation paid in this State (see Section 100.7010 of this Part) to an individual is required to deduct and withhold from such compensation for each payroll period (as defined in 26 USC 3401), an amount computed in accordance with IITA Section 701 and 702. Illinois income tax is not required to be withheld on any compensation paid in this State of a character which is not subject to federal income tax withholding (whether or not such compensation is subject to withholding for federal taxes other than income tax, e.g. F.I.C.A. (Social Security taxes). (As to what constitutes "transacting business within this State," see Section 100.7020 of this Part).

As this Section indicates, Illinois withholding is only required in respect of compensation subject to federal income tax withholding. Whether or not federal income tax withholding is required is a question of federal law.

If the Internal Revenue Service deems amounts paid to nonresident aliens in the form of scholarships, fellowships, grants, financial aid, stipends, tuition waivers or any other financial aid are not wages for federal income tax purposes, then Illinois will not treat such payments as wages, and Illinois income tax withholding will not be required.

Voluntary withholding agreements are expressly allowed by Department of Revenue Regulation Section 100.7070.

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If the taxpayer is not under audit and it wishes to obtain a binding Private Letter Ruling regarding their factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b). If you have any further questions, you may contact me at (217) 524-7580.

Sincerely,

Matthew Crain  
Associate Counsel (Income Tax)